

Message Text

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ACTION EUR-12

INFO OCT-01 EA-12 IO-14 ISO-00 AID-05 CIAE-00 EB-08
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P R 112148Z APR 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC PRIORITY 5009
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
AMCONSUL BELFAST
AMCONSUL EDINBURGH
USMISSION GENEVA
USDOC WASHDC

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USEEC ALSO FOR EMBASSY
USOECN ALSO FOR EMBASSY
USMTN

DEPARTMENT PASS FEDERAL RESERVE BOARD; TREASURY FOR
DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON' EFIN, UK
SUBJECT: HMTREASURY FORECASTS OF THE BRITISH ECONOMY
IN CHANCELLOR HEALEY'S BUDGET REPORT

SUMMARY: IN ITS STATUTORY FORECAST, H.M. TREASURY FORE-
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SEES MODEST ECONOMIC GROWTH AND A CURRENT ACCOUNT SURPLUS
OVER THE NEXT YEAR. THE ECONOMIC GROWTH AND THE SURPLUS
ARE, HOWEVER, LESS THAN EARLIER ENVISAGED. THE CURRENT
ACCOUNT, IN FACT, IS FORECAST TO REACH ITS NEAR-TERM PEAK
IN THE SECOND HALF OF 1978, DESPITE THE REVERSAL OF RE-
CENT LOSSES IN LABOR COST COMPETITIVENESS. INCREASES IN
CONSUMPTION, ENCOURAGED BY PRICE DECELERATION AND TAX

CUTS, WILL BE THE PRIMARY FORCE IN INCREASING AGGREGATE
-DEMAND. END SUMMARY.

1. THE H.M. TREASURY FORECASTS NOW EXTEND THROUGH THE
FIRST HALF OF 1979. THE FOLLOWING TABLE SUMMARIZES THE
FORECASTS THROUGH THIS 12-MONTH PERIOD.

A. OUTPUT AND EXPENDITURE AT CONSTANT 1970 PRICES

PERCENT CHANGES, FIRST HALF 1978

TO FIRST HALF 1979:

GROSS DOMESTIC PRODUCT (AT FACTOR COST) 3

CONSUMER EXPENDITURE 4

GENERAL GOVERNMENT EXPENDITURE ON

GOODS AND SERVICES 2-1/2

OTHER FIXED INVESTMENT 1/2

OF WHICH

PRIVATE SECTOR MANUFACTURING 4-1/2

EXPORTS OF GOODS AND SERVICES 5-1/2

STOCKBUILDING (AS PERCENT OF GDP) 1/2

IMPORTS OF GOODS AND SERVICES 8

MANUFACTURING PRODUCTION 2-1/2

B. BALANCE OF PAYMENTS ON CURRENT ACCOUNT

POUNDS BILLION:

1978 FIRST HALF 1/4

SECOND HALF 1/2

1979 FIRST HALF 1/4

C. PUBLIC SECTOR BORROWING REQUIREMENT

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POUNDS BILLION--IN BRACKETS, PSBR

AS A PERCENTAGE OF GDP AT CUR-

RENT MARKET PRICES

FINANCIAL YEAR 1977-78 5-1/2 (4 PERCENT)

FINANCIAL YEAR 1978-79 8-1/2 (5-1/4 PERCENT)

D. RETAIL PRICE INDEX

PERCENT CHANGE:

FOURTH QUARTER 1977 TO

FOURTH QUARTER 1978 7

SECOND QUARTER 1978 TO

SECOND QUARTER 1979 8

2. IT IS MENTIONED AS A TECHNICAL NOTE THAT THE CON-
STANT PRICE ESTIMATES OF GDP ARE MADE WITH 1970 WEIGHTS.
AS A RESULT OF PERIODICALLY UPDATING ITS ECONOMIC STA-
TISTICS, CONSTANT PRICE STATISTICS ARE BEING REBASED TO
1975 IN THE COURSE OF THIS YEAR. THE GREATER WEIGHT GIVE
TO PETROLEUM IN THE LATER WEIGHTS AND THE STRONG GROWTH

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OF THIS SECTOR IN THE U.K. WOULD ADD ABOUT 3/4 PERCENT
TO THE CONSTANT PRICE GROWTH RATE OF GDP.

3. AVERAGE PAY INCREASES (SEASONALLY ADJUSTED, AVERAGE
EARNINGS) ARE EXOGENOUS VARIABLES IN THE TREASURY FORE-
CAST. THEY ARE ASSUMED TO INCREASE IN THE YEAR BEGINNING
AUGUST 1978, WHICH CORRESPONDS TO THE INCOMES POLICY
YEAR, BY ABOUT HALF THE AVERAGE OF THE CURRENT PAY ROUND.
NO FURTHER DETAILS ARE GIVEN. ON THE OTHER HAND, THE EX-
CHANGE RATE IS ASSUMED TO BE SET "BY MARKET FORCES," WITH
LABOR COST COMPETITIVENESS IMPROVING THROUGHOUT 1978 TO
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"LEVELS ROUGHLY EQUIVALENT TO THOSE OF 1977." THE FAVOR-

ABLE EFFECTS THAT THE EXCHANGE RATE APPRECIATION OF 1977 AND DECLINES IN INTERNATIONAL COMMODITY PRICES HAVE HAD ON RETAIL PRICES ARE NOT FORESEEN TO CONTINUE. EVEN THE WAGE MODERATION ASSUMED IS NOT JUDGED SUFFICIENT TO KEEP RETAIL PRICE INCREASES FROM ACCELERATING IN THE FIRST HALF OF 1979.

4. THE MOST IMPOSING COMPONENT OF REAL GDP GROWTH IS CONSUMPTION. THE INCREASE IN CONSUMPTION BETWEEN THE CALENDAR YEARS 1977 AND 1978 IS NEARLY TWICE THAT OF REAL GDP ITSELF. THE RISE IN CONSUMPTION EXPENDITURE IS BASED IN FACT ON EXPANDED DISPOSABLE PERSONAL INCOME WHICH IN TURN IS BEING BOOSTED BY TAX REDUCTIONS AND SLOWER PRICE INCREASES. NO EXPLICIT RECOGNITION OF REAL BALANCE EFFECTS IS GIVEN.

5. THE FORECAST LEVEL OF PRIVATE INVESTMENT IS NOTED TO BE LOWER THAN DEPARTMENT OF INDUSTRY SURVEY EVIDENCE SUGGESTS. SUCH SURVEYS HAVE BEEN OPTIMISTIC IN THE PAST. THEY GENERALLY SUGGEST MUCH MORE RAPID SHIFTS IN INVESTMENT LEVELS THAN SLUGGISH ECONOMETRIC FORECASTS.

6. THE BALANCE OF PAYMENTS FORECAST IS LARGELY FROM A TREASURY ECONOMETRIC MODEL. THE DOCUMENT NOTES, HOWEVER THAT IN 1977, U.K. EXPORT PERFORMANCE WAS IN FACT BETTER THAN PAST EXPERIENCE WOULD HAVE SUGGESTED, TAKING INTO ACCOUNT BOTH THE DEPRESSED LEVELS OF WORLD TRADE AND THE LEVEL OF U.K. COMPETITIVENESS. IT IS THOUGHT THAT WORLD TRADE WILL INCREASE 6-1/2 PERCENT AND TRADE IN MANUFACTURES 7-1/2 PERCENT IN 1978.

7. GENERAL GOVERNMENT EXPENDITURE WILL RISE BUT 1.2 PERCENT
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CENT BETWEEN CALENDAR YEARS 1977 AND 1978. THIS, HOWEVER IS THE NET EFFECT OF GOVERNMENT CONSUMPTION RISING 2.3 PERCENT AND GOVERNMENT INVESTMENT FALLING 6.3 PERCENT.

8. SINCE THE FORECAST PERIOD WAS EXTENDED IN TODAY'S BUDGET MESSAGE, AND SOME STATISTICS REGROUPED,

IT IS NOT POSSIBLE TO COMPARE PRECISELY THE MOST RECENT FORECASTS WITH PREVIOUS ONES. A SUFFICIENT NUMBER OF PERIODS HOWEVER OVERLAP TO ALLOW SOME INSIGHT INTO THE CHANGES. THESE CHANGES ARE ATTRIBUTABLE NOT ONLY TO ALTERED ASSUMPTIONS AND POLICIES BUT ALSO ALTERED VIEWS OF THE NATIONAL AND INTERNATIONAL ECONOMY. THE FOLLOWING TABLE COMPARES SOME OF THE APRIL 1978 BUDGET FORECASTS FOR THE CALENDAR YEARS 1977 AND 1978 WITH THOSE FROM THE NOVEMBER 1977 MINI-BUDGET. (MILLIONS/POUNDS 1970 PRICES)

NOV 1977 MINI-BUDGET APR 1978 BUDGET

| | FORECAST | | FORECAST | |
|----------------------------------|----------|--------|----------|--------|
| | 1977 | 1978 | 1977 | 1978 |
| GDP AT FACTOR COST | 48,100 | 49,550 | 48,300 | 49,250 |
| CONSUMER EXPENDITURE | 35,150 | 36,350 | 35,150 | 36,900 |
| STOCKBUILDING | 250 | 350 | 400 | 100 |
| (BILLIONS/POUNDS, CURRENT PRICE) | | | | |
| CURRENT ACCOUNT | 0.250 | L.500 | - 0.035 | 0.750 |

9. THE MOST RECENT FORECASTS, IN PARTICULAR, LOWER THE ESTIMATE OF 1978'S GDP GROWTH FROM THE NOVEMBER FORECAST LEVEL OF 3.0 PERCENT TO 2.0 PERCENT. THE GROWTH OF REAL CONSUMPTION ON THE OTHER HAND IS SET AT 5.0 PERCENT IN TH MOST RECENT FOR.ECAST AGAINST 3.4 PERCENT IN THE EARLIER ONE. THE CHANGE IN THE CURRENT ACCOUNT FORECAST IS LIKEWISE STRIKING.

10. H.M. TREASURY PROVIDES SEVERAL GUIDES TO THE ACCURAC OF ITS FORECASTS. AS AN EXAMPLE,IT IS NOTED THAT FOR THE SECOND HALF YEAR OF ITS EARLIER FORECAST PERIODS, THE CUR RENT ACCOUNT FORECAST HAD AN AVERAGE DEVIATION FROM THE UNCLASSIFIED

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TRUE OUTCOME OF 1-1/2 PERCENT OF GDP. APPLYING THIS DE- VIATION TO THE CURRENT ACCOUNT FORECAST FOR THE SECOND HALF OF 1979, H. M.TREASURY REMARKS, WOULD IMPLY A FORE- CAST MARGIN OF 1 BILLION POUNDS ON EITHER SIDE. BREWSTER

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